**C-ECO 204: Fundamentals of Economic Theory (CBCS)**

**Group A**

### Topic 4: Market Structure

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**Market**

Ordinarily, the term “market” refers to a particular place where goods are purchased and sold. But, in economics, market is used in a wide perspective. In economics, the term “market” does not mean a particular place but the whole area where the buyers and sellers of a product are spread.

This is because in the present age the sale and purchase of goods are with the help of agents and samples. Hence, the sellers and buyers of a particular commodity are spread over a large area. The transactions for com­modities may be also through letters, telegrams, telephones, internet, etc. Thus, market in economics does not refer to a particular market place but the entire region in which goods are bought and sold.

**Types of Market structure**

There are quite a few different market structures that can characterize an economy. The four basic types of market structures are as follows:

Perfect Competition, Monopolistic Competition, Oligopoly and Monopoly.

Each of them has its own set of characteristics and assumptions, which in turn affect the decision making of firms and the profits they can make.

**Features of different types of Market structure**

## **1. Perfect Competition**

Perfect competition describes a market structure, where a large number of small firms compete against each other. In this scenario, a single firm does not have any significant market power. As a result, the industry as a whole produces the socially optimal level of output, because none of the firms can influence market prices.

The idea of perfect competition builds on several assumptions:

(1) large number of buyers and sellers

(2) there is free entry and exit to the market

(3) all firms sell completely identical (i.e., homogenous) goods

(4) all firms maximize profits

## **2. Monopolistic Competition**

Monopolistic competition also refers to a market structure, where a large number of small firms compete against each other. However, unlike in perfect competition, the firms in monopolistic competition sell similar, but slightly differentiated products. That gives them a certain degree of market power, which allows them to charge higher prices within a certain range.

Monopolistic competition builds on the following assumptions:

(1) all firms maximize profits

(2) there is free entry, and exit to the market

(3) firms sell differentiated products

(4) consumers may prefer one product over the other

## **3. Oligopoly**

An oligopoly describes a market structure that is dominated by only a small number of firms. That results in a state of limited competition. The firms can either compete against each other or collaborate. By doing so, they can use their collective market power to drive up prices and earn more profit.

The oligopolistic market structure builds on the following assumptions:

(1) all firms maximize profits

(2) oligopolies can set prices

(3) there are barriers to entry and exit in the market

(4) products may be homogenous or differentiated

(5) there is only a few firms that dominate the market

## **4. Monopoly**

A monopoly refers to a market structure where a single firm controls the entire market. In this scenario, the firm has the highest level of market power, as consumers do not have any alternatives. As a result, monopolies often reduce output to increase prices and earn more profit.

The following assumptions are made when we talk about monopolies:

(1) the monopolist maximizes profit

(2) it can set the price

(3) there are high barriers to entry and exit

(4) there is only one firm that dominates the entire market.

## **Summary**

There are four basic types of market structures: perfect competition, monopolistic competition, oligopoly and monopoly. Perfect competition describes a market structure, where a large number of small firms compete against each other with homogenous products. Meanwhile, monopolistic competition refers to a market structure, where a large number of small firms compete against each other with differentiated products. An Oligopoly describes a market structure where a small number of firms compete against each other. And last but not least, a monopoly refers to a market structure where a single firm controls the entire market.